

Clarifying Guidance – A-123 Risk Assessment Process

Purpose:

The purpose of this guidance is to clarify the risk assessment guidelines presented in the A-123 Evaluating Quick Start Guide (QSG). This guidance does not “change” or add additional requirements to the QSG materials. It is intended only to provide a more detailed discussion of the risk assessment methodology presented therein.

Definitions:

The following provides definitions for key terms used in this guidance:

- 1) Risk/Risk Activity – The potential negative result that could occur if/assuming controls are not working or in place to prevent it from occurring. Risks exist in all activities; however, the number and severity of risks varies greatly.
- 2) Inherent Risk Rating/Assessment – The general rating of risk (High, Medium or Low) based on the impact and likelihood of the risk/risk activity occurring, excluding consideration of how controls may affect the likelihood or impact.
- 3) Impact – The potential negative effect the risk might cause given the general environment. Notice the definition specifies “general” environment and not “control” environment. Impact is a part of the inherent risk assessment; therefore, as stated in number 2 above, actual controls in place or control environment do not influence the outcome. The general environment may however affect the impact rating and will be discussed later in this guidance. Impact considers both the nature and extent of the effect of the risk. Impacts are defined and rated as high, medium or low.
- 4) Likelihood – The relative potential (chances) the risk might occur given the general environment. Notice the definition specifies “general” environment and not “control” environment. Likelihood is a part of the inherent risk assessment; therefore, as stated in number 2 above, actual controls in place or control environment do not influence the outcome. The general environment does however affect likelihood and will be discussed later in this guidance. Likelihood is evaluated and rated as high, medium or low.

Risk Assessment Steps:

In its simplest form, the risk assessment process may be broken down into 4 key steps.

1) Risk definition –

Risk definition takes place during the documenting phase. A well-defined risk will also include a statement of the impact the risk would have. This provides the basis

for the assessment of impact. The following is an example of a well-defined risk statement for a funds control sub-process:

Ex. Obligations may exceed authorized funding levels, resulting in invalid balances and Anti-deficiency Act violations.

2) *Assessment of “impact” (refer to definition 3) –*

The assessment of impact takes place during the evaluation phase. In this step, the negative effect the risk might cause given the general environment is evaluated. As stated earlier, controls in place or the control environment do not influence the impact rating, since it is part of an inherent risk assessment. The “nature” and “extent” of the impacts are key considerations.

General environment considerations that may affect impact include (but are not limited to):

- Number of transactions running through an activity.
- Dollar value of transactions/items running through an activity.
- Volume of people with access to an activity.

The following provides two examples of impact statements and how the general environment may affect the impact rating ...

Ex. 1 – General environment supports high impact rating

Risk/Risk Activity = Assets acquired by purchase card may not be recorded in property records

Impact Statement = Asset records and costs are misstated.

Impact Rating = High

Rationale = General environment characteristics are as follows: Site has hundreds of purchase card holders; millions of dollars in assets are acquired per year via the program. Potential for significant dollar impact, as well a fraud, waste and abuse is increased due to amount of activity. [Note that here the “extent” of the impact is a key consideration – leading to a high impact rating.]

Ex 2 – General environment supports low impact rating

Risk/Risk Activity = Assets acquired by purchase card may not be recorded in property records

Impact Statement = Asset records and costs are misstated.

Impact Rating = Low

Rationale = General environment characteristics are as follows: Site has one purchase card holder; annual purchases for the cardholder are approximately \$100; assets are prohibited items. Potential for significant dollar impact, as well as fraud, waste and abuse is minimal due to amount of activity. [Note that here the “extent” of impact is a key consideration – leading to a low impact rating.]

In the preceding examples, the general environment greatly affected the impact rating. However, in some cases, the general environment may not be a consideration. For example, if the potential impact is “violation of the Anti-Deficiency Act,” it does not matter whether the violation is \$2 or \$2 million. Violations of law can have devastating impacts. It also does not matter how many people could cause the violation. It only takes one to have a major impact. Similarly, if we added “fraud, waste and abuse” to the impact statement in the examples, we might consider both impact and likelihood to be high. [Note that here the “nature” of the impact is the key driver, not extent.]

3) *Assessment of “likelihood” (refer to definition 4).*

The assessment of likelihood takes place during the evaluation phase. In this step, the relative potential (chances) of the risk occurring given the general environment is evaluated. As stated earlier, controls in place or the control environment do not influence the impact rating, since it is part of an inherent risk assessment.

General environment considerations that may affect likelihood include (but are not limited to):

- Number of transactions running through an activity.
- Volume of people with access to an activity.
- Liquidity of assets or inherent susceptibility to theft or misuse.
- Variety of backgrounds/knowledge of personnel with access to an activity.
- Level of automation in the activity (highly automated, no automation).

The examples from section 2 will now be looked at from the standpoint of likelihood...

Ex 1 – General Environment supports high likelihood rating

Risk/Risk Activity = Assets acquired by purchase card may not be recorded in property records

Likelihood Rating = High

Rationale = General Environment Considerations are as follows: Site has hundreds of purchase cards; cardholders average 1200 purchases, with \$50 million running through purchase cards each year; property is not a prohibited item; cardholders are spread throughout the site and have varied backgrounds (e.g. scientists, accountants, maintenance workers, cafeteria staff, etc.); and purchase cards represent cash (highly liquid).

Ex 2 – General Environment supports low likelihood rating

Risk/Risk Activity = Assets acquired by purchase card may not be recorded in property records

Likelihood Rating = low

Rationale = General Environment Considerations are as follows: Site has one cardholder; cardholder averages 2 purchases and \$100 per year; property is a prohibited item; cardholder is a procurement contracting officer. Likelihood is low due to the limited exposure and generally exclusive environment.

4) *Assignment of overall risk rating (refer to definition 2).*

The overall risk rating is an automatic calculation based on the likelihood and impact ratings. The risk assessment matrix showing how likelihood and impact are weighted can be found in the evaluating quick start guide.